



# Those Ethical Lapses: Why and How?

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Where we are . . .

**Some scary slides**



# Scary Story

- A New York City building inspector expedited a developer's paper work in exchange for:
  - The developer paying off the inspector's \$200,000 mortgage
  - The developer buying the inspector two SUVs
  - The developer paying for a Royal Caribbean cruise for the inspector and his wife (\$8,000)



# More Scary Headlines

- “Safety Citations and Anonymous Deaths,” *New York Times*, November 27, 2015, p. A1.
  - “Most construction sites where workers died failed to take basic steps to prevent them from falling. Workers frequently did not wear harnesses or helmets, as required by law. Supervision was often lacking. In many of the projects, a premium was placed on speed, causing workers to take dangerous shortcuts.”
- “New Jersey Transit Was Under Investigation Before Fatal Crash in Hoboken,” *New York Times*, Oct. 2, 2016, p. A24.
- “Ex-Chief of Massey Energy Convicted of Lesser Counts in Miners’ Deaths,” *New York Times*, December 4, 2015, p. A16.



# More Scary Headlines

“Ex-Official Enters Plea Deal on Flint Water,” *New York Times*, September 16, 2016, p. A14.

“Man Killed in Wall Collapse Had Warned of Problems,” *New York Times*, September 5, 2015, p. A18.

“Dozens of NYC Building Inspectors & Contractors Nabbed in Bribery Bust,” *New York Daily News*, February 11, 2015.

“Manslaughter Charges for Construction Managers After Worker Dies in Pit Collapse,” *New York Times*, August 6, 2015.

“Prosecutor Blames Cut Corners for Collapses,” *USA Today*, August 29, 2016, p. 3A. (Italy)

“If the buildings had been constructed as they are in Japan, they wouldn’t have collapsed.”



# DOE IG Reports

- “Washington River Protection Solutions Agrees to Pay \$5.275 Million to Settle False Overtime and Premium Pay Allegations,”  
January 23, 2017
  - Time card fraud
  - General counsel (with no audit experience) installed as head of the contractually required internal audit department



# General Issues in Projects

- Lack of oversight of contractor labor force
- Conflicts of interest regarding award of contracts on projects
- Accelerated disbursements to “rescue” failing contractors
- Mismanagement and cover-up



# Flint, Michigan

- *“The tragedy that we know as the Flint water crisis did not occur by accident. No. Flint was a casualty of arrogance, disdain and a failure of management, an absence of accountability, shirking of responsibility.” Michigan AG*
- 13 charged
- Two guilty pleas



# Flint, Michigan

- *“The Flint water crisis is a story of government failure, intransigence, unpreparedness, delay, inaction, and environmental injustice.”* Governor’s Task Force Report (2016)
- Federal action delayed
- Delegation of authority among and between state, local, and federal agencies
- Suppression of mounting evidence of problems
- Dismissive response to expressed concerns



# Employee Survey on Ethical Issues

- Number one self-confessed ethical breach: Saying you have performed processes, procedures, tests, and inspections when you have not done so
- Number two is falsifying paperwork to verify tests/inspections
- Number three is completion dates
- Number four is misstating costs



# Some Observations



**a. This can happen to anyone, and has happened to many, even the best of the best.**



# Ethical Lapses Since 2001

Adelphia	ADM	AIG (three times)	Allergan
Alstom	American Apparel	American Express	Apple (twice)
Apollo Global	Apollo Goupr	Arthur Andersen	AstraZeneca
AT&T	Autonomy	Avon	Bally Total Fitness
Bank of America	Barclays	Bayer	BCBS
BCCI	BDO Seidman	Bear Stearns	Biovail
Blue Bell	BNY		
BNP Paribus	Body Shop	Boeing	BP (3 times)
Bristol-Myers Squibb	Calpers	Cardinal Health	Caterpillar
Cendant	Chase	Chesapeake Energy	Chipotle
Chiquita			
Chrysler (2)	Cintas	Citigroup	Columbia HCA
Computer Associates	Countrywide	CSFB	CVS



# Ethical Lapses Since 2001

Davis-Besse (FENOC)	DaVita Health	Deloitte Touche	Delphi
Deutsche Bank	Dewey LeBeouf	Diamond Nuts	Downey S & L
Duke Energy (2)	DuPont	Edward Jones	Eli Lilly
Enron	Entergy	Ernst & Young	Facebook
Fannie Mae (2)	Fidelity Invest.	FIFA	Fireman's Fund
Freedom Industries		Galleon Hedge	
General Electric	General RE	GlaxoSmithKline (4)	Global Crossing
Global Research	GM	Goldman Sachs (2)	Google
GroupOn	Hallmark Westland	HealthSouth	Helig-Myers
Herbalife	HP	HSCB	Hyundai
Ikea	ImClone	IndyMac	Johnson & Johnson
Kia	Kindred Healthcare	Kmart	KPMG (2)



# Ethical Lapses Since 2001

Krispy Kreme	Lehman Bros.	Lennar	Lifelock
Lucent	Madoff Invest.	Marriott Int'l	Marsh & McLennan
Massey Energy			
Merck	Merrill Lynch	MF Global	Microstrategy
Milberg Weiss	Mitsubishi	Moody's	Morgan Stanley
Mylan	Navient	Navistar Int'l	
New Century	New Eng. Patriots	New Orleans Saints	Nortel
Novartis	Och-Ziff	Options (200)	Oracle
Olympus		Parmalat	
Peanut Corp.	Penn State	Pfizer	Pilot Flying J
PriceWaterhouseCoopers	Prudential	Putnam (2)	Qualcomm
Qwest	Razorfish	RBS	Reebok
Refco	Royal Ahold	Royal Shell	SAC Capital



# Ethical Lapses Since 2001

St. Louis Cardinals	Saks Fifth Avenue	Sallie Mae (17)	Samsung
Satyam (India)	Shaw Group	Siemens	Société General
Standard & Poor's	Stanford Investments	Stanford University	Student loan lenders
Taco Bell	Takata	Taylor Beane	Tenet
Tesco	Tesla	TierOne Bank	Titan
Toshiba	Toyota		
Trinity Highway	Turing Pharma.	Tyco Int'l	UBS
United Health	Universities & Sports	Universities	Valeant
Volkswagen	Wachovia	Walmart	WaMu
Wells Fargo (3)	World Bank	World Com	Xerox
Zynga			



## **b. Nothing That Happened Was a Close Call: Clear Ethical Lapses**

- Conflicts of interest
- Bribery
- Lying to employees
- Withholding information from investors
- Lying about time and inspections
- Misuse of funds or embezzlement
- Alteration of documents
- False reports and stonewalling auditors
- False résumés
- Office affairs



# Construction Fraud

- Minority business enterprises (MBEs)
- Bidding fraud
  - Complementary (“cover” or “courtesy” bids)
  - Bid rotation
  - Bid suppression (withdrawal or no-submits)
  - Market allocation
  - Subcontracting with bid winner
  - Contractor-owned equipment rental
- Billing fraud
  - Meters vs. yards



**c. Those involved were aware of their ethical lapses.**



# Donald Trump on Contracting

*“When I build something for somebody, I always add \$50 million or \$60 million onto the price. My guys come in, they say it is going to cost \$75 million. I say it’s going to cost \$125 million and I build it for \$100 million. Basically, I did a lousy job. But they think I did a great job.”*

Donald Trump

*Forbes*, June 12, 2009, p. 120





# The Careful Language Upon Confrontation

- *“I am not aware of any wrongdoing on my part.”*
  - Martin Winterkorn, former CEO of VW, (September 2015)
- *“[Deception] was not a corporate decision; this was something individuals did.”*
  - Winfried Vahland, head of VW North American for 3 weeks.
  - Mike Spector and Amy Harder, “VW’s U.S. Chief Apologizes, Says Engineers at Fault,” *Wall Street Journal*, October 9, 2015, B1.



# Volkswagen and Fake Emissions

- *“Inquiries had been hampered by a culture of fear and silence.”*
- *“In the course of internal investigations, employees have admitted that there were irregularities in communication of fuel consumption values.”* Jack Ewing, “Under New Management, Volkswagen’s Investigation Turns Up a Whistle-Blower” *New York Times*, Nov. 8, 2015, p. B1.



# NASA's Long History

- Apollo 1 Launch Pad Fire
- Challenger Disaster
- Hubble Space Telescope Issue
- Space Walk: the leaky suit



# Gene Krantz, NASA Flight Director: Schedule Pressure

*“We were too gung-ho about the schedule and we locked out all of the problems we saw each day in our work. . . . Not one of us stood up and said, “Damn it, STOP!”*”

Addressing Mission Control following the launch pad fire that took the lives of Apollo 1 astronauts Gus Grissom, Ed White, and Roger Chaffee (January 30, 1967)



# NASA's Report on the Shuttle

*“ . . . I don't know what Congress communicated to O'Keefe. I don't really understand the criticality of February 19<sup>th</sup>, that if we didn't make that date, did that mean the end of NASA? I don't know . . . I would like to think that the technical issues and safety resolving technical issues can take priority over any budget or scheduling issue. ”*



# NASA on the Near-Drowning in the Suit (during a space-walk)

February 25, 2014

- *“While I am concerned about ensuring this particular incident does not happen again, I am especially concerned about cultural factors that may have contributed to the event. In our exuberance to get the job done, we may have allowed ourselves to accept the commonly accepted causes for small anomalies. We have a responsibility not to move on from any abnormal situation until we understand it fully or have suitable mitigations to prevent it from happening again. Our work both in-house and with our industry and commercial partners should entail diligence in assessing risk and commitment to ensuring mission safety.”*



# North Carolina Athletic Cheating Scandal

- *“I’m not sure which is worse: the idea that the coaches at North Carolina had an inkling of the academic fraud and did nothing about it or that they had absolutely no knowledge for over a quarter of a century.”*
  - A sports fan



**So, what to do?**



# 1. Understand that we don't have isolated rogues and that there are cultural issues.

- *"This is not our culture."* Mary Barra GM CEO (following engine switch revelations)
- *"We don't have a culture of bad behavior at Baylor University."* Mack Rhodes (AD)
- *"This is not our culture."* Wells Fargo (former CEO) following revelations on account falsification and termination of 5300 employees



# Penn State

- *“Why would you think we have a culture problem here?”*
  - Question raised by faculty member after Sandusky, along with university officials, was indicted



# The employees ate our culture?

- *“The employees did not honor our culture [of putting the customer first]. I don’t want them here. I really don’t.”*
  - Wells Fargo CEO John Stumpf (former)



# Wells Fargo and Pressure

- Quarterly bonuses for new accounts and new account services
- Result: Fake accounts, employee accounts, employee family accounts, accounts without customer knowledge, and closing of accounts
- 5300 employees terminated
- Morale of those not terminated
- Shareholder revolt on compensation
- Five executives terminated or have left



# Wells Fargo Fallout

- \$190 million fine (so far)
- Estimated cost \$1.2 billion
- SEC investigation (false financials released)
- Criminal investigation
- Reputation
- Where are new accounts going now?
- Trust



# Incentive Fixes

- Are there factors that cost employees incentives and bonuses?
- The rolling averages – three-year cycle
- Do you change incentives when you realize perverse effects on behavior? Judgment?
- The “Sandbox” effect
- Examples of things we do not do to achieve results (credo discussion)



**2. Compliance budgets and ethics efforts are not guarantees.**



# A Sample Dashboard

	Over all (2014)	Organizations with ethical lapses (collected after their lapses and during investigations)
Code of ethics	97%	100%
Ethics training	81%	95%
Compliance officer	50-60%	100%
Component of evaluation	67%	85%
Investigation process	60-70%	100%
Audit committee reporting line	65-75%	100%



**3. All ethical issues are not the same.**



# Ethical Issues vs. Ethical Culture

## INDIVIDUAL

Decisions for personal benefit without externalities

*Cheating on a diet, borrowing without asking, blaming others, embezzling, shoplifting.*

## ORGANIZATION

Decisions influenced by company pressures

*Cheating to qualify for bonuses, taking shortcuts to meet deadlines, not reporting violations*

## INDUSTRY

Decisions influenced by industry and competition

*Using steroids, manipulating financial results, dodging regulations*

## SOCIETY

Decisions made based on cultural norms

*Speeding, cheating on exams, bribing officials, manipulating taxes, using fake ID, discrimination*



# 4. The Beginning and Those Gray Areas: The Common Factors

- Economic pressure
  - Downturns
  - Business model is dated
  - Over-expansion
  - Competition
  - Saving face
  - Deadlines
- Examples
  - Shaw at Brown's Ferry
  - Flint water system
  - VA



# Blue Bell Creameries

- 09/18/2012 – “Crickets shall be removed, eradicated from milk storage rooms & evaporator room.”
- 11/20/2013 – “Find source of mildew in 40-degree room.”
- 12/18/2013 “Rainbow fruit freeze is now 120 hours old! Use ASAP.”
- 2014 – rust on doorways
  - not closing lids on various food containers
  - no towels available at hand-wash sinks.



# Blue Bell Creameries

- Increasing demand led to extraordinary pressures on production.
- At main Brenham plant a machine— nicknamed Gram — was running 24-7, made it difficult to get it clean.
- “It was run, run, run.”
- The plant had to keep churning.
- Listeria in 13 states, 3 deaths, and 800+ ill



**5. It all starts small as compensation for management issues.**



# Costs of Slippage

*It's the missing hand rail in the shower that will result in the greatest number of injuries and your highest costs.*





**Tackling the comfort tools that permit the slippage  
from gray to .....?**



# The “It’s a Gray Area” Rationalization

- Why is it important that it be gray to you?
- Is it legally gray?
- Is it ethically gray?
- Is it a good-faith disagreement?
- What if it’s not a gray area?
- Does everyone believe it’s a gray area?
- Interpretation vs. loophole vs. nondisclosure of relevant information

*“There will always be a gray area.”*

M.M. Jennings



# Legalisms: The Story of the Axe

Half-truths and technical truths:

- “Have you seen the axe lately?”
- “Could you go and look for the axe?”
- “Let’s go look for the axe together.”
- “Have you used the axe lately?”
- “Was the last time you saw the axe when we split wood together?”

*Withholding the truth is not managing a situation.*





# Comfort From “Warm” Labels

The “way harsh” language	The “warm” language
“Cooking the books”	“Financial engineering”; “Getting results”; “Smoothing earnings”; “Managing earnings”
“Backdating options”	“Periodic look-backs”
“You lied”	“I misremembered” “I failed to live up to my duty of candor.” “I gave the least untruthful answer I could.”
“You lied”	“I misspoke” “I was just managing the optics.” “I told you versions of the truth.”
“You lied”	“I just managed expectations.” “I used incremental escalations of half-truths.”



# More Warm Language

You lied.	“I used imprecise communication.” “We have additional information that appears to be inconsistent with our previous response.” “We had irregularities in communication.”
You lied.	“We lost focus on the facts.”
You lied.	“Facts receded in memory or awareness.”
You lied.	“I short-circuited.”



## **6. Avoid the Corner of No Choices**



# An Observation

The first whale to the surface always gets harpooned.

*What does this phrase mean?*



# Drawing Them Out

- Be the last one to speak in a meeting when you are in charge
- Draw out those who have remained reticent
- Conduct a Challenge Meeting
- Watch attrition, terminations, and turnover
- Jack Welch: “Anything I have not heard?”
- Are those who raise concerns promoted?
- Alan Mulally at Ford



# The Chalk Line

*What lines are smudging  
ever so gradually?*





# Front-Page-of-the-Newspaper Test

What if the cameras were running? Would you be proud of the discussion? Would you worry about what you are doing being made public?



**If you were on the other side . . .**